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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No.

WEST PRODUCTION COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

PETITION.

The West Production Company, by its counsel, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered July 7, 1941, affirming a decision of the United States Board of Tax Appeals.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 91-108) is published at 41 B. T. A. 1043. The opinion of the Circuit Court of Appeals (R. 143-147) is reported in 121 F. (2d) 9.

Jurisdiction.

The judgment of the Circuit Court of Appeals sought to be reviewed was entered July 7, 1941. Jurisdiction to issue the writ requested is found in Section 240 of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

A debtor failed to pay taxes and other charges on collateral securing notes. To protect its interest, the creditor was compelled to foreclose and buy in the collateral. Is the price bid at the foreclosure sale, or the fair market value of the assets acquired, to be used in computing gain or loss for Federal tax purposes?

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in the appendix, *infra*, pp. 14-36.

Summary Statement of Matter Involved.

Several issues were involved in this case in the court below. Certiorari is sought on one issue only. It involves the following facts:

October 27, 1931, R. S. Sterling obtained a loan from a bank in the amount of $800,000.00 secured by various properties pledged under a deed of trust. The loan was evidenced by notes.

On June 20, 1932, the West Production Company purchased the outstanding notes for $324,039.00. After the purchase of the notes, the West Production Company received $118,891.98 previously paid on the loan, plus $165,000.00 realized from the sale, with Sterling's consent, of part of the collateral, thus making its net cost of the remaining notes $40,147.02.

Sterling failed to pay taxes and other charges on the properties covered by the deed of trust. Accordingly, the properties were sold October 4, 1932, at public auction on

the steps of the Harris County, Texas, Courthouse. At that time there were accrued and unpaid taxes due on the properties, and payments were also due on account of the principal of loans against the properties. One property alone had a debt of $143,000.00 against it.

At the sale the persons in attendance were given the opportunity to bid on any separate item of personal or real property. The West Production Company bid in the real property for $17,300.00, and the personal property for $1,500.00, a total of $18,800.00. The Sterling notes were not cancelled and are still in the possession of the West Production Company.

The Commissioner of Internal Revenue held that the properties acquired at the foreclosure had a fair market value on October 4, 1932, of $205,414.00; that the bid price on foreclosure should be ignored, and that the West Production Company realized a taxable profit on the purchase.

The parties stipulated that "In the event the Board should hold that the values as of date of acquisition should be considered in computing income of petitioner", the fair market value of the properties purchased, as of October 4, 1932, was $101,522.77.

By using the stipulated value, rather than the bid price, the Board of Tax Appeals held that the West Production Company realized a gain on the purchase of $61,375.75. The Circuit Court of Appeals affirmed the Board of Tax Appeals.

Both decisions below were based on Article 193, Treasury Regulations 77, promulgated under Section 23 of the Revenue Act of 1932, which deals with deductions from gross income, and not with gain, and which states that gain or loss can be realized by a purchase at foreclosure.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

(1) In holding that the bid price of the assets purchased at foreclosure sale was not to be used in computing Federal tax.

(2) In holding that the stipulated fair market value of the assets acquired, rather than the bid price at a foreclosure sale, was to be used in computing the Federal tax of the purchaser.

(3) In basing its decision on a regulation dealing with deductions from gross income and which has no statutory authority for taxing gains on purchase at foreclosure.

Reasons Relied on for the Allowance of the Writ.

I.

The basic question is pending before this Court and is in a state of conflict and confusion.

Several cases are now pending before this Court involving situations where bondholders or creditors bought in the debtor's property at foreclosure. The cases present two questions:

(1) Were the transactions statutory "corporate reorganizations" and

(2) Is the basis for computing depreciation (a) the cost to the predecessor organization, (b) the bid price, or (c) the fair market value on the date of acquisition. Circuit Courts of Appeals' decisions hold all three ways.

In the cases mentioned, the Government takes the position that the bid price establishes the basis. We believe that position to be correct and that justice demands the writ issue in this case in order that this taxpayer be placed on the same footing as other taxpayers buying property at foreclosure.

The cases pending before this Court are:

Nos. 128 and 129, *Bondholders Committee etc.* v. *Helvering* and *Marlborough House Inc.* v. *Helvering*, 118 F. (2d) 511. The Government's memorandum does not oppose certiorari and states (p. 2):

> "The question is the basis for depreciation, under Sections 23 (k), 113 and 114 (a) of the Revenue Act of

> 1932, of corporate assets bought in at equity foreclosure sale by a bondholders' committee * * *."

The Circuit Court of Appeals for the Ninth Circuit held that the basis was the price paid at the foreclosure sale. On page 3, the Government's memorandum states:

> "Accordingly, although we believe the instant case was correctly decided by the court below, we do not oppose the granting of the writs in view of the conflict between the circuits and the manifest importance of the question in the administration of the revenue laws."

No. 286, *Commissioner* v. *Southwest Consolidated Corporation,* 119 F. (2d) 561. The Fifth Circuit held there was a statutory reorganization, so the assets took the basis of the predecessor corporation. The Government's petition says the Fifth Circuit committed error in holding there was a "reorganization" and (p. 5):

> "In failing to hold that the basis of the assets was their cost to the bondholders' committee at the foreclosure and receivership sales."

No. 328, *Commissioner* v. *Alabama Asphaltic Limestone Co.,* 119 F. (2d) 819, is also a Fifth Circuit case wherein it was held that there was a statutory reorganization. In the Government's petition, it is alleged that error was committed by the Circuit Court of Appeals in holding there was a reorganization and (p. 5):

> "In failing to hold that the basis of the assets was the cost to the creditors' committee at the bankruptcy sale."

No. 503, *Palm Springs Holding Corporation* v. *Helvering,* 119 F. (2d) 846 (C. C. A. 9). The Government's memorandum states (pp. 2-3):

> "The Court below sustained the Commissioner's determination that the basis for depreciation was the cost of the property at the foreclosure sale * * *. Accordingly, although we believe the instant case was cor-

rectly decided by the court below, we do not oppose the granting of the writ in view of the conflict among the circuits and the importance of the question in the administration of the revenue laws."

July 14, 1941, the Eighth Circuit decided *Helvering* v. *New President Corporation,* not yet officially reported, but reported at ¶62,831, Prentice-Hall Federal Tax Service, wherein it was held that the fair market value, and not the bid price, was to be used as the basis of assets purchased at foreclosure. Counsel is informed that the Government will seek certiorari in the *New President* case.

The only difference between the cases cited and the case at bar is that in the cited cases the debtor was a corporation, while in the case at bar the debtor was an individual.

In the case at bar, it was held that the bid price did not govern and that inquiry must be made to determine the "fair market price". That position is directly contrary to the position taken by the Government in the above listed cases in this Court.

II.

Decision of the cases pending in this Court will affect the problem in the case at bar.

The statute provides that the basis for determining gain or loss, and for depreciation and depletion, is cost, increased or decreased by certain adjustments not applicable here. (Secs. 113 and 114, Revenue Act of 1932.)

In the several cases now pending before this Court, the Government is insisting that cost is the proper basis in the case of property bought at foreclosure. Such a position is obviously correct, as the law is established that actual cost paid at a foreclosure sale establishes the said basis, irrespective of fair market value. *Pelham Hall Co.*, 33 B. T. A. 329; *La Arcada Bondholders Committee*, 35 B. T. A. 80.

Consequently, in the case at bar the taxpayer must use its cost of $18,800.00, as the basis for determining gain or

loss or depreciation and depletion. Yet, the Commissioner of Internal Revenue has treated as income, and taxed, the difference between $18,800.00 and $101,522.77!

There is absolutely no statutory provision which will enable the taxpayer to recover through sale, or by depreciation, the difference between the price paid and the "fair market value", as of the date of the foreclosure sale.

Is this Court going to hold, as the Government contends in the pending cases, that the basis of property purchased at foreclosure is the actual cost thereof, and yet permit the purchaser to be taxed on an amount in excess of the price paid? The two questions are inseparably joined and if certiorari is not granted in this case, the question will inevitably arise in other cases. The Court should dispose of the entire problem at this time.

III.

The decision below is in conflict with a decision of this Court which holds that the bid price governs and that a mortgagee who purchases at foreclosure is in a position no different from that of a stranger.

In *Helvering* v. *Midland Mutual Life Insurance Co.*, 300 U. S. 216, the Court was asked to decide if a mortgagee realized interest income when it bought property at foreclosure on a bid of the amount of the loan plus accrued and unpaid interest. The Court states the situation as follows (p. 233):

> "A mortgagee who, at foreclosure sale, acquires the property pursuant to a bid of the principal and accrued interest is, as purchaser and grantee, in a position no different from that of a stranger who acquires the property on a bid of like amount. It is true that the latter would be obliged to pay in cash the amount of his bid, while the formality of payment in cash is ordinarily dispensed with when the mortgagee acquires the property on his own bid. But the rights acquired *qua* purchasers are the same in either case; * * *"

While life insurance companies are not taxed on capital transactions, obviously the rule of the Midland case is general and applies to individual and ordinary corporation taxpayers. If a mortgagee and a stranger are in the same position when buying property at foreclosure, it is obvious that no income was realized when the West Production Company purchased the property here involved, because if a stranger had purchased, he would not be subject to tax until the property was sold. "A mortgagee * * * is in a position no different from that of a stranger".

It is no answer to the Midland decision to say that the case involved a narrow question of whether a life insurance company had received "interest". The entire basis of the decision is that a mortgagee has the same standing as a stranger.

The Ninth Circuit has followed the Midland Mutual case by holding that, for tax purposes, the bid price governs irrespective of the actual value of the assets purchased. *Tiscornia* v. *Commissioner*, 95 F. (2d) 678, involved a situation wherein the trustee for certain noteholders foreclosed and bid in the property securing the notes. The trustee then gave to each noteholder his proportionate shares of stock in a new corporation to which the assets were transferred. A question arose as to the cost of the property acquired at the foreclosure sale. The Court says (p. 683):

> "We hold upon the authority of *Helvering* v. *Midland Mutual Life Insurance Co.*, 1937, 300 U. S. 216, that for the purpose of the present tax calculation, the cost of this property to petitioner is established by the bid price thereof at the foreclosure sale, without regard to its actual market value. * * * If mortgage principal, plus interest thereon, is considered for tax purposes to be recovered when property is acquired on a bid equal to their total, then it follows that the cost of the property so acquired is for tax purposes the amount bid therefor."

IV.

The Treasury Regulation that gain can be realized by a purchase at foreclosure is based on the loss section of the statute and is invalid. The action of the court below in upholding such a Regulation is in conflict with many decisions.

It can be safely stated that income is not realized by the purchase of property, no matter how favorable the purchase may be.

> "Normally, the purchase of property does not result in the realization of taxable gain, but rather in the acquisition of an asset with a view to the later realization of gain or profit through its use or subsequent sale * * *". *Delbert B. Geeseman,* 38 B. T. A. 258, 263.

The same case also states (p. 264):

> "Furthermore, it is not at all unusual that the purchaser of property may through his ability and shrewdness as a buyer, or by reason of other influences or forces, be able to purchase property at a price substantially lower than the price at which it may be immediately sold, but it does not follow that gain is presently realized through such a purchase." (Citing authorities)

Let us assume that a member of this Court invested in a real estate mortgage note. After buying the note, he discovered taxes were delinquent and, if he were to save his investment in the note, he must foreclose and buy in the property. Would he realize income by this continuing outgo of cash?

There is absolutely no statutory provision which authorizes the computation of a gain by purchase. Section 22 defines gross income and specifically includes income from sales.

Section 23 authorizes certain deductions from gross income, including losses.

Section 111 deals with the computation of gain or loss from "the sale or other disposition of property".

Section 112 covers recognition of gain or loss determined under Section 111.

Sections 113 and 114 deal with the basis for determining gain or loss and for depreciation and depletion, respectively.

Nowhere in the statute covering income is mention made of purchases, and gain from purchases cannot possibly be read into the statute. Despite this, Article 193 of Regulations 77, interpreting deductions from income under Sec. 23 of the statute, provides that gain or loss is realized upon a purchase by a creditor at foreclosure. Such a regulation has been in force since the Revenue Act of 1926. (The year here involved is 1932.) The rule to be followed is well expressed in *Koshland* v. *Helvering*, 298 U. S. 441, 445:

> "We give great weight to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has re-enacted the statute without change. The question here, however, is not merely of our adopting the administrative construction but whether it should be adopted if in effect it converts an income tax into a capital levy."

The Court then holds that the Treasury is without power to enlarge the statute by regulations.

In *Manhattan General Equipment Co.* v. *Commissioner*, 297 U. S. 129, it is stated (p. 134):

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress— • • • ".

In this case the Commissioner of Internal Revenue by regulation has attempted to make law by ruling that income is realized by purchase. Obviously, the regulation attempts to enlarge the statute and is a nullity.

It should be mentioned that the case at bar apparently is the only case in which the Courts have upheld the regula-

tion to tax a gain, unless *Helvering* v. *New President Corporation,* (C. C. A. 8), not yet officially reported but reported at ¶ 62,831 Prentice-Hall Federal Tax Service, is finally construed to so hold. The other reported decisions allow losses in hard cases.

It should be remembered that Sec. 23 of the statute deals with losses and other deductions from gross income, so the decisions allowing losses on foreclosures are justified. There is no corresponding statutory provision authorizing the taxation of gains on purchase at foreclosure.

IV.

The decisions of the Board of Tax Appeals support the taxpayer's contentions.

The Board of Tax Appeals in the unreported memorandum opinion[1] in *Egbert J. Henschel* v. *Commissioner,* Docket No. 83783, promulgated April 30, 1938, ¶ 6.207 Prentice Hall Federal Tax Service for 1938 was confronted with a situation where the decedent in 1927 sold certain real estate and took back a purchase money mortgage for $12,500.00. In 1934 the mortgage was in default and was foreclosed. The taxpayer bid $8,000.00 for the property. Expenses of sale and taxes amounted to $1,325.00. The Commissioner held that, on the date of the foreclosure sale, the fair market value of the property was $22,000.00 and determined that the taxpayer had realized a gain of $8,175.00. The Board states:

> "The real question in this proceeding is whether petitioners' decedent realized any gain or loss in 1934 on the personal property he held, namely a claim against a debtor for $12,500 secured by a mortgage on realty, when decedent foreclosed the mortgage. Respondent has treated the foreclosure as an exchange of personal property for real property and refers to our decision

[1] Memorandum opinions are rendered by the Board in cases where the law on the subject involved is settled, or where the peculiar facts in the case would not make it a precedent.

in *Henry Heldt*, 16 B. T. A. 1035. The facts in this proceeding are different from the facts in the *Heldt* case. There a creditor did exchange a note secured by a mortgage for a deed to the mortgaged realty. The creditor gave $1,000 cash and cancelled a note with accrued interest due in consideration for a deed to realty. We held there that the transaction constituted an exchange of one asset for another that gave rise to gain to the creditor, who was the petitioner in that case. However, here the petitioners' decedent neither sold nor exchanged the property consisting of his claim. He realized on the security he held, which at sale brought $8,000.00, which was applied in partial satisfaction of the claim against a debtor. Partial satisfacton of an obligation does not constitute a sale or exchange of the obligation. See *Hale* v. *Helvering*, 85 Fed. (2) 819. We hold, therefore, that petitioners' decedent realized no gain from applying the value of the collateral in partial satisfaction of the debt to him."

The case of *Manomet Cranberry Co.*, 1 B. T. A. 706, acquiesced in by the Commissioner, C. B. June 1925, p. 3, arose under an earlier Treasury Regulation. In that case, the taxpayer sold property in 1916 and took back a mortgage. In 1919 it bought back the property on foreclosure. The Board said the Commissioner should not treat the transaction in a manner "where the result may be to impose a tax upon the increment which may never be realized", stating (p. 709):

> "There is no evidence to show that the property was worth more than the price so paid for it; but, even if there were, it would not constitute a realized gain until such time as the property might be disposed of."

The *Manomet* case was followed by the Board in *I. M. Davis*, 2 B. T. A. 359, the Board stating (p. 360):

> "We think that the contention of the taxpayer is correct in that there would be no realized gain in the repossession of the property by the taxpayer until such time as the property might be disposed of."

One line of cases, illustrated by *Henry Heldt*, 16 B. T. A. 1035, holds that where the debtor transfers the purchased property back to the seller, there is an exchange by the creditor of his debt asset for a property asset and gain or loss results. The case at bar differs from this line of cases because: (1) the taxpayer did not sell and later repossess the property involved and (2) the debt asset was not exchanged for the property asset.

The Board of Tax Appeals' decision in the case at bar is based on *Hadley Falls Trust Co.* v. *U. S.* (C. C. A. 1), 110 F. (2d) 887, which allowed a loss on the foreclosure of a mortgage. The Court clearly points out that its conclusion is based on Sec. 23 of the Revenue Act of 1928, which specifically allows deductions for losses and bad debts. There is no such statutory provision permitting the taxing of gain on foreclosure.

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition should be granted, limited to the purchase at foreclosure issue.

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September 1941.

APPENDIX.

Revenue Act of 1932:

SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after the date of the enactment of this Act, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly.

(b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

(1) LIFE INSURANCE.—Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or in installments (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income);

(2) ANNUITIES, ETC.—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the

amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph;

(3) GIFTS, BEQUESTS, AND DEVISES.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

(4) TAX-FREE INTEREST.—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. Every person owning any of the obligations or securities enumerated in clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations and securities owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from the taxes imposed by this title;

(5) COMPENSATION FOR INJURIES OR SICKNESS.—Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(6) MINISTERS.—The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(7) MISCELLANEOUS ITEMS.—The following items, to the extent provided in section 116:

Earned income from sources without the United States;

Salaries of certain Territorial employees;

The income of foreign governments;

Income of States, municipalities and other political subdivisions;

Receipts of shipowners' mutual protection and indemnity associations;

Dividends from China Trade Act corporations.

(c) INVENTORIES.—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) DISTRIBUTIONS BY CORPORATIONS.—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

(e) DETERMINATION OF GAIN OR LOSS.—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

(f) GROSS INCOME FROM SOURCES WITHIN AND WITHOUT UNITED STATES.—For computation of gross income from sources within and without the United States, see section 119.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) EXPENSES.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) INTEREST.—All interest paid or accrued within the taxable year on indebtedness, except (1) on indebtedness incurred or continued to purchase or carry ob-

ligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this title, or (2) on indebtedness incurred or continued in connection with the purchasing or carrying of an annuity.

(c) TAXES GENERALLY.—Taxes paid or accrued within the taxable year, except—

(1) income, war-profits, and excess-profits taxes imposed by the authority of the United States;

(2) income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of section 131 (relating to credit for taxes of foreign countries and possessions of the United States); and

(3) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

For the purpose of this subsection, estate, inheritance, legacy, and succession taxes accrue on the due date thereof, except as otherwise provided by the law of the jurisdiction imposing such taxes, and shall be allowed as a deduction only to the estate.

(d) TAXES OF SHAREHOLDER PAID BY CORPORATION.—The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

(e) LOSSES BY INDIVIDUALS.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

(f) Losses by Corporations.—Subject to the limitations provided in subsection (r) of this section, in the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

(g) Basis for Determining Loss.—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), shall be the adjusted basis provided in section 113 (b) for determining the gain or loss from the sale or other disposition of property.

(h) Loss on Wash Sales of Stock or Securities.—For disallowance of loss deduction in the case of sales of stock or securities where within thirty days before or after the date of the sale the taxpayer has acquired substantially identical property, see section 118.

(i) Net Losses.—The special deduction for net losses of a prior year, to the extent provided in section 117.

(j) Bad Debts.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(k) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the

allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

(l) DEPLETION.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion, see section 114(b) (3) and (4).)

(m) BASIS FOR DEPRECIATION AND DEPLETION.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

(n) CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or

educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(3) the special fund for vocational rehabilitation authorized by section 12 of the World War Veterans' Act, 1924;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see section 120.)

(o) Future Expenses in Case of Casual Sales of Real Property.—In the case of a casual sale or other casual disposition of real property by an individual, a reasonable allowance for future expense liabilities, incurred under the provisions of the contract under which such sale or other disposition was made, under such regulations as the Commissioner, with the approval of the Secretary, may prescribe, including the giving of a bond, with such sureties and in such sum (not less than the estimated tax liability computed without the benefit of this subsection) as the Commissioner may require, conditioned upon the payment (notwithstanding any statute of limitations) of the tax, computed without the benefit of this subsection, in respect of any amounts allowed as a deduction under this subsection

and not actually expended in carrying out the provisions of such contract.

(p) DIVIDENDS RECEIVED BY CORPORATIONS.—In the case of a corporation, the amount received as dividends—

(1) from a domestic corporation which is subject to taxation under this title, or

(2) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 119.

The deduction allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

(q) PENSION TRUSTS.—An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees (if such trust is exempt from tax under section 165, relating to trusts created for the exclusive benefit of employees) shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under subsection (a) of this section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made. Any deduction allowable under section 23 (q) of the Revenue Act of 1928 which under such section was apportioned to any taxable year subsequent to the taxable year 1931 shall be allowed as a deduction in the years

to which so apportioned to the extent allowable under such section if it had remained in force with respect to such year.

(r) LIMITATION ON STOCK LOSSES.—

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1), computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets.

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory, nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business.

(s) SAME—SHORT SALES.—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

(t) DEFINITION OF STOCKS AND BONDS.—As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, or (2) rights to subscribe for or to receive such shares, or (3) bonds, debentures, notes, or certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision

thereof), with interest coupons or in registered form, or (4) certificates of profit, or of interest in property or accumulations, in any investment trust or similar organization holding or dealing in any of the instruments mentioned or described in this subsection, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of this Act.

REGULATIONS 77.

Art. 193. *Uncollectible deficiency upon sale of mortgaged or pledged property.*—Where mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. In addition, where the creditor buys in the mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only when it has previously been returned as income.

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) COMPUTATION OF GAIN OR LOSS.—Except as hereinafter provided in this section, the gain from the sale

or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b), and the loss shall be the excess of such basis over the amount realized.

(b) AMOUNT REALIZED.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) RECOGNITION OF GAIN OR LOSS.—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(d) INSTALLMENT SALES.—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

(1) PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT.—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) STOCK FOR STOCK OF SAME CORPORATION.—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a

corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(c) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—

(1) If an exchange would be within the provisions of subsection (b), (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) SAME—GAIN OF CORPORATION.—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) LOSS FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(f) INVOLUNTARY CONVERSIONS.—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

(g) DISTRIBUTION OF STOCK ON REORGANIZATION.—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(h) SAME—EFFECT ON FUTURE DISTRIBUTIONS.—The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, if no gain to the distributee from the receipt of such stock or securities was recognized by law, shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining the taxability of subsequent distributions by the corporation.

(i) DEFINITION OF REORGANIZATION.—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) DEFINITION OF CONTROL.—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

(k) FOREIGN CORPORATIONS.—In determining the extent to which gain shall be recognized in the case of any of the exchanges or distributions (made after the date of the enactment of this Act) described in subsection (b) (3), (4), or (5), or described in so much of subsection (c) as refers to subsection (b) (3) or (5), or described in subsection (d) or (g), a foreign corporation shall not be considered as a corporation unless, prior to such exchange or distribution, it has been established to the satisfaction of the Commissioner that such exchange or distribution is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) BASIS (UNADJUSTED) OF PROPERTY.—The basis of property shall be the cost of such property; except that—

(1) INVENTORY VALUE.—If the property should have been included in the last inventory, the basis shall be the last inventory value thereof.

(2) GIFTS AFTER DECEMBER 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner.

(3) TRANSFERS IN TRUST AFTER DECEMBER 31, 1920. —If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made.

(4) GIFT OR TRANSFER IN TRUST BEFORE JANUARY 1, 1921.—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in section 402(e) of the Revenue Act of 1921, or in section 302(f) of the Revenue Act of 1924 or the Revenue Act of 1926 (relating to property passing under power of appointment) regardless of the time of acquisition.

(5) PROPERTY TRANSMITTED AT DEATH.—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death.

(6) TAX-FREE EXCHANGES GENERALLY.—If the property was acquired upon an exchange described in

section 112(b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

(7) Transfers to Corporation Where Control of Property Remains in Same Persons.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) Property Acquired by Issuance of Stock or as Paid-in Surplus.—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including also, cases where part of the

consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

(9) TAX-FREE DISTRIBUTIONS.—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112(g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed.

(10) INVOLUNTARY CONVERSION.—If the property was acquired as the result of a compulsory or involuntary conversion described in section 112(f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

(11) WASH SALES OF STOCK.—If the property consists of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this Act or corresponding provisions of prior income tax laws, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, then the basis shall be the basis of the stock or securities so sold or disposed of, increased or decreased, as the case may be, by the difference, if any, between the price at which the property was acquired

and the price at which such substantially identical stock or securities were sold or otherwise disposed of.

(12) PROPERTY ACQUIRED DURING AFFILIATION.—In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to inter-company transactions in respect of which gain or loss was not recognized. For the purposes of this paragraph, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928. The basis in case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this Act or the Revenue Act of 1928, shall be determined in accordance with regulations prescribed under section 141 (b) of this Act or the Revenue Act of 1928. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this Act or the Revenue Act of 1928, shall be adjusted in respect of any items relating to such period, in accordance with regulations prescribed under section 141 (b) of this Act or the Revenue Act of 1928, applicable to such period.

(13) PROPERTY ACQUIRED BEFORE MARCH 1, 1913.—In the case of property acquired before March 1, 1913, if the basis otherwise determined under this subsection, adjusted as provided in subsection (b), is less than the fair market value of the property as of March 1, 1913, then the basis shall be such fair market value. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

(b) ADJUSTED BASIS.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

(C) in respect of any period prior to March 1, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent sustained;

(D) in the case of stock (to the extent not provided for in the foregoing subparagraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921).

(2) SUBSTITUTED BASIS.—The term "substituted basis" as used in this subsection means a basis determined under any provision of subsection (a) of this section or under any corresponding provision of a prior income tax law, providing that the basis shall be determined—

(A) by reference to the basis in the hands of a transferor, donor, or grantor or

(B) by reference to other property held at any time by the person for whom the basis is to be determined.

Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, then the adjustments provided in paragraph (1) of this subsection shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) BASIS FOR DEPRECIATION.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain or loss upon the sale or other disposition of such property.

(b) BASIS FOR DEPLETION.—

(1) GENERAL RULE.—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

(2) DISCOVERY VALUE IN CASE OF MINES.—In the case of mines (other than metal, coal or sulphur mines) discovered by the taxpayer after February 28, 1913,

the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit.

(3) PERCENTAGE DEPLETION FOR OIL AND GAS WELLS.—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

(4) PERCENTAGE DEPLETION FOR COAL AND METAL MINES AND SULPHUR.—The allowance for depletion shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for de-

pletion) from the property, except that in no case shall the depletion allowance for the taxable year 1932 or 1933 be less than it would be if computed without reference to this paragraph. A taxpayer making return for the taxable year 1933 shall state in such return, as to each property (or, if he first makes return in respect of a property for any taxable year after the taxable year 1933, then in such first return), whether he elects to have the depletion allowance for such property for succeeding taxable years computed with or without reference to percentage depletion. The depletion allowance in respect of such property for all succeeding taxable years shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for succeeding taxable years shall be computed without reference to percentage depletion. During the period for which property acquired after December 31, 1933, is held by the taxpayer—

(A) if the basis of the property in the hands of the taxpayer is, under section 113(a), determined by reference to the basis in the hands of the transferor, donor, or grantor, then the depletion allowance in respect of the property shall be computed with or without reference to percentage depletion, according to the method of computation which would have been applicable if the transferor, donor, or grantor had continued to hold the property, or

(B) If the basis of the property is, under section 113(a), determined by reference to the basis of other property previously held by the taxpayer, then the depletion allowance in respect of the property shall be computed with or without reference to percentage depletion, according to the method of computation which would have been applicable in respect of the property previously held if the taxpayer had continued to hold such property.

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422085—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 674

WEST PRODUCTION COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 91–108) is reported in 41 B. T. A. 1043. The opinion of the Circuit Court of Appeals (R. 143–147) is reported in 121 F. (2d) 9.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 7, 1941. (R. 147–148). The petition for a writ of certiorari was filed on October 1, 1941. The jurisdiction of this Court is in-

voked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a secured creditor who buys in the underlying property at foreclosure, realizes income in the amount of the difference between the fair market value of the property acquired and the cost of the debt.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 11–12.

STATEMENT

On October 27, 1931, R. S. Sterling obtained a loan of $800,000 secured by various properties pledged under a deed of trust. The loan was evidenced by notes due on or before January 1, 1934, bearing 6 percent interest. One of the properties pledged was Sterling's undivided interest in the Moss Bluff Oil Field. (R. 48–49.)

Prior to June 20, 1932, Sterling asked J. M. West, chairman of taxpayer's board of directors, to buy up the notes at a discount. Upon learning that the Humble Oil & Refining Company was interested in acquiring the Moss Bluff properties, West ascertained the price which Humble would pay for the Moss Bluff properties, and, after Sterling had agreed to the sale of the properties to Humble, negotiated for the purchase of the notes. (R. 93.)

On June 20, 1932, taxpayer purchased the Sterling notes for $320,000 and paid legal expenses of $4,039 in connection therewith. At the time of the purchase the taxpayer received cash previously paid on the notes in the amount of $118,891.98. (R. 49, 93–94.) The Moss Bluff properties were sold to Humble and on July 21, 1932, the trustee paid the taxpayer $165,000 on account of the sale of Sterling's interest in the Moss Bluff properties. (R. 49, 94.)

Sterling defaulted upon the payment of taxes and other charges on properties covered by the deed of trust and the taxpayer thereupon directed the trustee to sell the property and to apply the proceeds toward the payment of the notes. The property was sold at public sale on October 4, 1932, the personal property separately from the real property. Taxpayer bought the personalty for $1,500 and the realty for $17,300. On October 10, 1932, taxpayer received from Sterling a quitclaim deed to the realty and a bill of sale for the personalty. (R. 49–51, 94–95.) The Sterling notes were not cancelled and are still in taxpayer's possession, and no further attempt has been made to collect on them. (R. 50, 95.) The parties stipulated that the fair market value on October 4, 1932, of all the properties, real and personal, which the taxpayer acquired was $101,522.77.[1] (R. 54–56.)

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[1] This figure includes the sum of $9,534.59 received in cash by the taxpayer on October 28, 1932, as additional pro-

The Board of Tax Appeals held (R. 100–101) that the purchase by the taxpayer of the Sterling notes, the sale of a portion of the collateral, and the acquisition of the remainder were all parts of an entire transaction which taxpayer undertook and carried out during the year 1932 for profit and on which taxpayer had realized a profit. The profit was computed by the Board as follows (R. 100–101):

Amount realized:	
Cash acquired when the notes were purchased	$118,891.98
Received from Humble for interest in Moss Bluff properties	165,000.00
Fair market value of remaining collateral at date of foreclosure sale	101,522.77
	385,414.75
Cost of Sterling notes	324,039.00
Total gain realized	$61,375.75

The Circuit Court of Appeals affirmed the Board of Tax Appeals on this point. (R. 145–147.)

ARGUMENT

1. Taxpayer alleges as a ground for the granting of the writ that the question presented in this case is inseparably joined to the question pre-

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ceeds from the sale of the Moss Bluff properties to Humble. (R. 49, 56, 94.)

Taxpayer mentions (Pet. 3) that one of the properties which it acquired upon the foreclosure sale had a debt of $143,000 against it. That indebtedness was taken into consideration, and allowance made for it, in fixing the stipulated fair market value of all of the properties as $101,522.77. (See R. 55–56.)

sented in *Bondholders Committee, etc.* v. *Helvering,* and *Marlborough House, Inc.* v. *Helvering,* Nos. 128 and 129; *Helvering* v. *Southwest Consolidated Corp.,* No. 286; *Helvering* v. *Alabama Asphaltic Limestone Co.,* No. 328; and *Palm Springs Holding Co.* v. *Helvering,* No. 503. These cases are now pending in this Court on petitions for writs of certiorari which were granted October 13, 1941. The question presented in these cases is whether, when bondholders of an insolvent corporation foreclose and form a new corporation to take over the property, the new company is one formed pursuant to a "reorganization" so that it may use the basis of the assets in the hands of the old company for the purposes of computing depreciation and depletion, and gain or loss upon the subsequent disposition of the assets. In none of these cases is this Court required to decide whether, if the transactions did not constitute a reorganization, the new company must use as its basis the bid price or the fair market value on the date of acquisition. That question was involved in the companion case of *Helvering* v. *New President Corp.,* 122 F. (2d) 92 (C. C. A. 8th), in which the court determined that such transaction did not constitute a reorganization but held further that the taxpayer was entitled to use as its basis the fair market value of the property acquired as opposed to the bid price. That result is con-

sistent with the result herein. The Government does not intend to seek certiorari in the *New President* case, and since the decision in the *New President* case is in the taxpayer's favor, a petition will not be filed by the taxpayer. Therefore the pendency of the other cases raising the unrelated question whether there was a reorganization is not a ground for the granting of the writ in this case.

2. The decision below is not in conflict with *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216. In the *Midland* case a life insurance company had bid in property upon which it held a mortgage at a price which included both the principal and interest due on the mortgage debt. This price was bid in order to insure that there would be no loss to the mortgagee on its investment in case of redemption by the mortgagor. The Court decided that the amount of the bid referrable to the interest on the debt constituted income to the mortgagee, but pointed out that it was dealing only with the construction of a section of the revenue act taxing life insurance companies upon "interest" received, and that such companies were taxed in a special manner. Moreover, in the instant case, both the Board of Tax Appeals and the Circuit Court of Appeals have grounded their holdings squarely upon Article 193 of Treasury Regulations 77, promulgated under the Revenue

Act of 1932. As the court below noted, an identical regulation has been promulgated under every revenue act since that of 1926.[2] Under the well settled rule this consistent administrative interpretation of the statute together with the reenactment of the statute by Congress has given the regulation the force and effect of law.[3] No comparable regulation—indeed, no regulation at all—was involved in the *Midland* case. Furthermore, Section 111 (b) of the Act specifically provides that "The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received." The regulation upon which the decision herein rests provides that where a creditor buys in the pledged property he realizes gain or loss in the amount of the difference between the fair market value of the property and the amount of the obligations of the debtor which are applied to the purchase or bid price of the property. In the absence of proof to the contrary the bid price is presumed to be the fair market value. In the instant case the fair

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[2] Treasury Regulations 69, Article 153; Treasury Regulations 74, Article 193; Treasury Regulations 77, Article 193; Treasury Regulations 86, Article 23 (k)–3; Treasury Regulations 94, Article 23 (k)–3; Treasury Regulations 101, Article 23 (k)–3; Treasury Regulations 103, Sec. 19.23 (k)–3.

[3] *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459; *Helvering* v. *Winmill*, 305 U. S. 79, 83.

market value was stipulated by the parties and therefore there is no warrant for the use of the bid price in the computation of gain or loss. The validity of the regulation has been sustained by the Circuit Courts of Appeals for the First, Third and Eighth Circuits. *Hadley Falls Trust Co.* v. *United States,* 110 F. (2d) 887 (C. C. A. 1st); *Malden Trust Co.* v. *Commissioner,* 110 F. (2d) 751 (C. C. A. 1st); *Brown* v. *United States,* 95 F. (2d) 487 (C. C. A. 3d); *Helvering* v. *New President Corp.,* 122 F. (2d) 92 (C. C. A. 8th). All of these cases were decided after the decision in the *Midland* case and there are no contrary decisions. *Tiscornia* v. *Commissioner,* 95 F. (2d) 678 (C. C. A. 9th), is not in conflict for, as the court carefully noted, there was no evidence in the record of fair market value, and, moreover, the conclusion reached by the court is strictly in accordance with the regulation.

3. Taxpayer contends that its acquisition of the pledged property resulted in no gain or loss. But essential facts are ignored in this attempt to treat the case as one of a simple purchase of property and to apply the argument that one does not realize income by the purchase of property at a price less than its value. The acquisition of the property at the foreclosure sale in this case was not the beginning of a transaction; on the contrary it was the end of a transaction entered into for profit.

The essence of the transaction may be stated as follows: the taxpayer exchanged $18,800 (bid price at foreclosure) worth of a debt[4] which had cost $40,147.02 (price of the Sterling notes less cash realized thereon) for property concededly worth $101,522.77. This was an identifiable event marking the realization of income (or loss) and such a transaction has been so viewed in the *Brown, Hadley Falls* and *Malden Trust* cases, *supra*. The decision below is obviously correct and the taxpayer alleges no conflict with any decision of any other court on this point.

Taxpayer argues (Pet. 7) that it would be required, upon a future sale of these assets, to use the bid price as its basis for the computation of gain or loss and that it therefore could never recover the difference between the fair market value and the bid price. But this is obviously incorrect for the regulation specifically provides: "If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition."

CONCLUSION

The case was correctly decided by the court below. The decision is not in conflict with any de-

[4] The deficiency actually determined in this case treats the balance of the debt as uncollectible, even though the taxpayer still has the Sterling notes.

cision by this Court or any other court. The petition should be denied.

Respectfully submitted.

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OCTOBER 1941.

APPENDIX

Statute and Regulations Involved

Revenue Act of 1932, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

* * * * *

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 193. *Uncollectible deficiency upon sale of mortgaged or pledged property.*—Where

mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. In addition, where the creditor buys in the mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only when it has previously been returned as income.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

WEST PRODUCTION COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY MEMORANDUM FOR PETITIONER.

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October 31, 1941.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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REPLY MEMORANDUM FOR PETITIONER.

I.

In the "Brief for the Respondent in Opposition" the statement is made, referring to *Bondholders Committee etc.* v. *Helvering* and *Marlborough House. Inc.* v. *Helvering*, Nos. 128 and 129; *Helvering* v. *Southwest Consolidated Corporation*, No. 286; *Helvering* v. *Alabama Asphaltic Limestone Co.*, No. 328; and *Palm Springs Holding Co.* v. *Helvering*,

No. 503 (certiorari granted in each case October 13, 1941), that (p. 5):

> "In none of these cases is this Court required to decide whether, if the transactions did not constitute a reorganization, the new company must use as its basis the bid price or the fair market value on the date of acquisition."

The above quoted statement is in conflict with the statements filed in behalf of the Government in the five cases mentioned.

In each of those cases, as is hereinafter set forth, there are two questions:

(1) Where bondholders or creditors buy in the debtor's property at foreclosure is there a "reorganization," and

(2) What is the basis of the property thus bought in.

In view of *Le Tulle* v. *Scofield,* 308 U. S. 415, and *Helvering* v. *Tyng,* 308 U. S. 527, this Court will probably agree with the Government that there was no reorganization. That being true, the remaining situation will be identical with the situation in the case at bar, *i. e.,* creditors will have bought in assets at a foreclosure sale.

If this Court adopts the Government's contentions on this point, it will hold that the bid price establishes the basis for depreciation and gain or loss on sale. Such is the established law as referred to at page 6 of the petition herein. The rule, naturally, will be of general application and will control over the Treasury Regulations to which the Government refers on page 7 of its brief. Consequently if the Government wins the cases referred to, the rule established will govern this taxpayer. While this Court has the question before it in the cases mentioned, it should grant the writ and decide this case, as this case is inseparably joined with the cases in which certiorari has been granted.

The following short discussion shows that the Government has stated to this Court that one of the principle issues in the said cases is the basis for depreciation of assets bought at foreclosure.

In Nos. 128 and 129, *Bondholders Committee etc.* v. *Helvering* and *Marlborough House, Ins.* v. *Helvering* (certiorari granted October 13, 1941), the Circuit Court of Appeals sustained the Commissioner and held

(1) That the purchase of assets by a bondholders committee was not a "reorganization" and

(2) That the basis of the assets acquired was the bid price.

The Government stated it believed the case was correctly decided by the Court below and did not oppose the granting of certiorari, stating (p. 2):

> "The question is the basis for depreciation • • • of corporate assets bought in at equity foreclosure sale by a bondholders' committee."

In No. 286, *Helvering* v. *Southwest Consolidated Corporation*, the Fifth Circuit decided against the Government, holding:

(1) That the purchase by a bondholders' committee at a foreclosure sale was a "reorganization" and

(2) That the basis of the assets was the cost to the predecessor corporation, or $8,995,724.91.

The Government contends before this Court that the basis of the assets is not the cost to the predecessor corporation, or the fair market value, ($1,766,694.98), but the bid price of $752,000.00.

In its petition in the *Southwest* case, the Government claims the Circuit Court of Appeals erred (p. 5):

> "In failing to hold that the basis of the assets was their cost to the bondholders' committee at the foreclosure and receivership sales."

No. 328, *Helvering* v. *Alabama Asphaltic Limestone Company,* involves a situation where a creditors' committee bought in the corporation's assets at bankruptcy sale. The Government's petition states (p. 4):

> "In computing its depreciation and depletion allowances for the year 1936, the taxpayer treated its assets as having the same basis that they had in the hands of the old corporation. The Commissioner, in determining the deficiency, used the cost of the assets to the committee as their basis; namely, the price paid at the bankruptcy sale. The Board of Tax Appeals rejected the commissioner's position, and the Court below affirmed."

The Government then alleges the Circuit Court of Appeals erred (p. 5):

> "In failing to hold that the basis of the assets was the cost to the creditors' committee at the bankruptcy sale."

It is interesting to note that in No. 328 the petition, on pages 5 and 6, refers to *Commissioner* v. *New President Corporation* (¶62,831 Prentice-Hall) wherein the Eighth Circuit overruled the Commissioner's determination that the bid price governs. Obviously, the Commissioner has consistently held, as the Government in these cases contends, that the bid price governs. If it governs in other cases, it obviously should govern in the case at bar. It should be parenthetically stated that counsel was informed by representatives of the Department of Justice that the Solicitor General authorized the filing of a petition for certiorari in the *New President* case. After the petition in the case at bar was filed, the said authorization was withdrawn.

In No. 503, *Palm Springs Holding Corporation* v. *Helvering,* the petitioner is a corporation formed by a bondholders' committee. The Committee bid in certain property at foreclosure sale. The Government's "Memorandum for Respondent" states (p. 2):

> "The question presented is whether the taxpayer may take as its basis for depreciation the basis of these assets in the hands of the Palm Springs Hotel Company and the Palm Springs Hotel Operating Company. The Court below sustained the Commissioner's determination that the basis for depreciation was the cost of the property at the foreclosure sale."

The foregoing clearly shows that the Government consistently sought certiorari in these cases so that this Court might determine the basis of assets purchased at foreclosure. Certiorari should issue in the case at bar so that the Court may decide the entire question and eliminate controversies which are bound to arise if the writ is not granted.

II.

The brief in opposition contends that this case is not in conflict with *Helvering* v. *Midland Mutual Life Insurance Co.*, 300 U. S. 216, discusssed at pp. 7-8 of the petition. In that case this Court decided for the Government and squarely held that:

> "A mortgagee who, at foreclosure sale, acquires the property pursuant to a bid of the principal and accrued interest is, as purchaser and grantee, in a position no different from that of a stranger who acquires the property on a bid of like amount."

The Government's brief in the case at bar argues that there is no conflict because in the *Midland* case an insurance company was involved. We have not reached the point where the very same act by an oil producing company and an insurance company has different legal consequences. It is certainly true that the Bureau of Internal Revenue has been giving the doctrine of the *Midland* case general application and has not limited it to insurance companies. As recently as October 7, 1941, the Board of Tax Appeals upheld the Commissioner's contention that the *Midland* case had general application. See *T. Eugene Piper*, 45 B. T. A. No. 49, ¶64,887 P-H.

III.

In this case the taxpayer bought notes, the notes became in default, and in order to protect its investment, the taxpayer had to buy in the security behind the notes at foreclosure. The sale was a midway and unexpected step in the entire transaction. When the assets are disposed of, the transaction will be completed. If you made an investment in a note and had to buy in the security in an effort to save something out of the venture, would you say that the purchase of the assets was the end of a transaction entered into for profit? Actually, it might be a step near the beginning, rather than the end, as it might take years to sell the security and clean up the whole transaction. Yet, the Government's brief ignores realities and states (p. 8):

> "The acquisition of the property at foreclosure sale in this case was not the beginning of a transaction; on the contrary it was the end of a transaction entered into for profit."

If an investor had many deals like this, and was compelled to bear a tax burden when the security was reduced to possession, he might find himself with no cash to pay taxes or carrying charges and be insolvent. Such a determination of "income" ignores reality.

IV.

The Government's brief makes no mention of the fact that the regulation which is the basis of the decisions below is founded on the loss section of the statute and is invalid. (See pp. 9-11 of petition.) At page 7 the respondent's brief argues that this transaction comes within Sec. 111 (b) of the Act dealing with *sales*. Such an argument is another illustration of ignoring reality. This taxpayer did not sell anything. All it has done is pay out. There is no statutory authority for taxing such outgo.

CONCLUSION.

Certiorari should issue to enable this Court to straighten out the present confusion surrounding purchases at foreclosure.

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October 31, 1941.